

The Service Occupation Tax is a tax imposed on the tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101 – 140.109. (This is a GIL.)

April 20, 2006

Dear Xxxxx:

This letter is in response to your letter dated March 25, 2005, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

The purpose of this letter is to obtain specific direction from the state taxing authorities relating to the taxability or exempt status of the service we provide to customers located in your state.

Facts:

We are an 'on-line' sales/use tax information provider with headquarters in the CITY/STATE area. As part of providing this service, we maintain a database of nationwide sales/use tax rates as well as other sales/use related information in servers located in our data center here in Seattle. The following information is provided to assist you in responding to our request.

- 1) When a customer wishes to utilize our service, they download a free program electronically that connects them to our online service and allows them to send their transactional data via the internet to our servers to obtain the needed tax calculation. The customer does not purchase any software or any other tangible personal property as part of the service.
- 2) As part of the initial set-up, the customer enters our website and configures nexus, as well as any special taxability rules or special exemption treatment.

- 3) Based on jurisdictional information provided, our system will perform an address validation process and if necessary correct the ship-to address.
- 4) Based on jurisdictional information provided, as well as any customized taxability rules that the customer configures, our system will generate a tax calculation and electronically send it back to the user's accounting system for invoice generation.
- 5) When a customer subscribes to our service they pay a small activation fee and afterwards pay a monthly fee based on a number of transactions that require a tax calculation.
- 6) The tax calculation data generated is stored on our servers and a customer can access and download the data at anytime for purposes of generating on-line informational reports and tax returns.
- 7) We are a channel-based seller and we utilize accounting software resellers to promote and sell our service to their existing clients as well as any new clients that they acquire. However, we do have 'home-office' sales and marketing folks located in different parts of the country for purposes of promoting our services and supporting our value added resellers.
- 8) For purposes of this request, it should be presumed that one of our sales and marketing folks will physically visit your state between (1) and (5) times in a given year to meet with and assist our resellers in their marketing and sales efforts.
- 9) As part of our service, a user has access to unlimited technical support without any additional cost to them.

Opinion Request:

Please advise on the following:

- 1) Is the service we provide (based on the facts outlined above) subject to sales/use tax in your state? If so, please provide all relevant statutes, regulations, technical bulletins and applicable court cases to support the state's position.
- 2) If our service is not subject to sales/use tax in your state, are we still required under your state statutes to register for sales tax purposes and file a sales/use tax return?

If you have any additional questions relating to our service, please feel free to contact me at your earliest convenience. Thanks for your assistance in providing this very important information.

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101.

If no tangible personal property is being transferred to the customer, then no Illinois Retailers' Occupation Tax or Use Tax would apply. Likewise, the Service Occupation Tax Act and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. See 86 Ill. Adm. Code 140.101 and 160.101. If no tangible personal property is being transferred to the customer incident to the services provided, then neither Illinois Service Occupation Tax nor Service Use Tax would apply.

Your letter request indicates that your customers download free software that allows the person to utilize your services. Canned software is taxable in Illinois as tangible personal property regardless of how the software is delivered or transmitted. When property is purchased and then given away, the donor has made a taxable use of the property by making such gift. Therefore, it is the donor of the gift who is deemed the end user of the property and who is subject to the Use Tax on the donor's cost price of the property, rather than the donee. See 86 Ill. Adm. Code Section 150.305(c).

Determinations regarding the subject of nexus are normally very fact specific. The Department has found that the best manner to determine nexus is for a Department auditor to examine all relevant facts and information. The following guidelines, however, may be useful to you in determining whether your company would be considered "a retailer maintaining a place of business in Illinois" subject to Use Tax collection obligations. Whether a retailer is subject to Illinois Retailers' Occupation Tax (sales tax) liability or is required to collect Illinois Use Tax from its Illinois customers depends upon whether that retailer has sufficient "nexus" with the State of Illinois so that the retailer will be subject to Illinois law. The following information outlines the principles of nexus.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers. Another type of retailer is the out-of-State Retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax law. The Supreme Court has set out a two-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis will trigger Use Tax collection responsibilities. See Brown's Furniture, Inc. v. Wagner, 171 Ill.2d 410 (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers'

Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. Sales of tangible personal property made in Illinois and delivered to purchasers in Illinois are subject to Retailers' Occupation Tax and any applicable local taxes. Persons considered being "retailers maintaining a place of business" because of their Illinois activities are required to collect Use Tax on sales made to all Illinois purchasers regardless of the manner in which the orders are placed.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel

EEB:msk